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IN THE

Supreme Court of the United States

OCTOBER TERM, 1956.

No. 223

PEBBLE SPRINGS DISTILLING CO.,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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INDEX

	PAGE
Citation to Opinions Below	1
Jurisdiction	2
Question Presented	2
Statutes Involved	3
Statement	3
Reasons for Granting the Writ	6
I. There Is a Conflict Among the Circuits	6
II. An Important Question of Federal Law Not Heretofore Decided by This Court Is Involved.	9
III. There Has Been Such a Radical Departure from Customary and Accepted Standards of Judicial Review as to Call for the Exercise by This Court of Its Supervisory Powers	13
IV. The Opinion Below Does Not Reach or Answer the Real Issue in Controversy. Review by This Court Is Therefore Necessary to Remove the Misunderstandings Which the Opinion Below Will Engender	18
Conclusion	20
Appendix A—Statutes	21
Appendix B—Opinions Below	23
Appendix C—Conflicting Opinion	42

Cases

Becher v. Commissioner (1954), 22 T. C. 932, Affirmed (2d Cir.—1955), 221 F. (2d) 252 10

Cortland Specialty Co. v. Commissioner (2d Cir.—1932), 60 F. (2d) 937 ..... 7, 8, 19

Goldstein Bros., Inc. v. Commissioner (7th Cir.—1956), 232 F. (2d) 566 16

Heller v. Commissioner (9th Cir.—1945), 147 F. (2d) 376 9

Helvering v. Alabama Asphaltic Limestone Company (1942), 315 U. S. 179 16

Helvering v. Southwest Consolidated Corporation (1942), 315 U. S. 194 16

Helvering v. Tex-Penn Oil Co. (1937), 300 U. S. 481. 6

Liddon v. Commissioner (6th Cir.—1956), 230 F. (2d) 304, Petition for Certiorari filed May 18, 1956 (No. 953—October Term, 1955) 9, 11

Mascot Stove Co. v. Commissioner (6th Cir.—1941), 120 F. (2d) 153 13

Morley Cypress Trust v. Commissioner (1944), 3 T. C. 84 10

Pinellas Ice & Cold Storage Co. v. Commissioner (1933), 287 U. S. 462 ..... 7, 19

Scofield v. San Antonio Transit Company (5th Cir.—1954), 219 F. (2d) 149 ..... 6, 8, 9, 19

Sun Properties, Inc. v. United States (5th Cir.—1955), 220 F. (2d) 171 10

Survaunt v. Commissioner (8th Cir.—1947), 162 F. (2d) 753 ..... 8, 9, 17

United States v. Arcade Company (6th Cir.—1953), 203 F. (2d) 230 ..... 6, 8, 19

Weiss v. Stearn (1924), 265 U. S. 242 6

Statutes

Revenue Act of 1926:
Section 203 7
Section 203(h)(1)(A) 7
Internal Revenue Code of 1939:
Section 23(f) 3
Section 23(s) 3
Section 24(b)(1)(B) 12, 18
Section 24(b)(1)(C) 3, 10, 17, 20
Section 24(b)(2)(C) 12
Section 112 ..... 7, 12
Section 112(b)(3) 2, 3, 4, 13, 14, 16
Section 112(b)(4) 2, 3, 4, 8, 13, 14, 16
Section 112(g) 7
Section 112(g)(1)(A) 7
Section 112(g)(1)(D) 2, 3, 7, 8, 15, 16
Section 122(a) 3
Section 122(b)(1) 3
Section 272 3
Section 3797(a) 12
Internal Revenue Code of 1954:
Section 267(b)(3) 3, 10, 17, 20
Section 354 3
Section 361 3
Section 368(a)(1)(D) 3
28 U. S. C. Section 1254(1) 2
Federal Income Tax Regulations:
Regulations 103, Section 19.112(g)-1 14
Regulations 103, Section 19.112(g)-2 14
Regulations 111, Section 29.112(g)-1 14
Regulations 111, Section 29.112(g)-2 14
Regulations 118, Section 39.112(g)-1 14
Regulations 118, Section 39.112(g)-2 15
Section 1.368-1, T. D. 6152 14
Section 1.368-2, T. D. 6152 15

Income Tax Rulings:

I. T. 1410, Cumulative Bulletin I-2, p. 25..... 15

G. C. M. 1977, Cumulative Bulletin VI-2, p. 168.. 15

Reference Work:

3 Mertens Laws of Federal Income Taxation, Section 20.50, p. 183..... 18

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Pebble Springs Distilling Co. prays that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Seventh Circuit entered in the above case on the 7th of March, 1956. A petition for rehearing was denied April 4, 1956.

CITATION TO OPINIONS BELOW

The opinion of the Tax Court is reported at 23 T. C. 196 and is printed in Appendix B hereof, *infra*, page 23.

The opinion of the United States Court of Appeals is

printed in Appendix B hereof, *infra*, page 33, and is reported at 231 F. (2d) 288.

JURISDICTION

The judgment of the Court of Appeals was entered March 7, 1956. Rehearing was denied April 4, 1956. The jurisdiction of this Court is invoked under 28 U. S. C. Section 1254(1).

QUESTION PRESENTED

Where a corporation with more than six hundred and sixty shareholders sells, in aid of liquidation, certain of its noninventory assets consisting principally of its real estate and machinery, which constitute less than six and one-half per cent in value of all of its assets, at a widely advertised public auction for $242,080 in cash to a corporation formed and wholly owned by a few individuals owning in the aggregate approximately seventy-six per cent of the seller's stock, and the purchasing corporation would not have entered a bid at the auction if a higher bid had been made, and neither the buyer nor seller was or ever had been a personal holding company or a foreign personal holding company, is it correct as a matter of law to disallow as a deduction to the selling corporation the loss it sustained on such sale on the ground that the sale, although at arm's length and solely for cash, nevertheless constituted a reorganization under Section 112(g)(1)(D) of the Internal Revenue Code of 1939 on which, under either Section 112(b)(3) or Section 112(b)(4) of the 1939 Code, no loss is recognized?

STATUTES INVOLVED

The statutory provisions involved are Sections 112(b)(3), 112(b)(4), 112(g)(1)(D) and 24(b)(1)(C) of the Internal Revenue Code of 1939, printed in Appendix A, *infra*, pages 21-22. Although the instant case arose under the Internal Revenue Code of 1939, Sections 354, 361, 368(a)(1)(D) and 267(b)(3), of the Internal Revenue Code of 1954 are nearly identical with, respectively, Sections 112(b)(3), 112(b)(4), 112(g)(1)(D) and 24(b)(1)(C) of the Internal Revenue Code of 1939. Hence the question involved is a continuing one.

STATEMENT

This proceeding involves Federal income taxes for the fiscal years ended March 31, 1947, and March 31, 1948. The basis of the jurisdiction of the court of first instance, The Tax Court of the United States, was a petition filed by the taxpayer pursuant to Section 272 of the Internal Revenue Code of 1939.

The petitioner contends that the loss of $551,428.54 it sustained on the sale of its noninventory assets[1] during its taxable year ended March 31, 1949, is deductible from gross income under the provisions of Section 23(f) of the Internal Revenue Code of 1939. If petitioner is correct, it had an operating loss that year which, under the provisions of Sections 23(s), 122(a) and 122(b)(1) of the Internal Revenue Code of 1939, is allowable as a net operating loss carry-back deduction to each of petitioner's two preceding taxable years.

The Court of Appeals held that said loss is not deductible, apparently on the ground that the sale constituted a reorganization under Section 112(g)(1)(D) of the 1939 Code on

1. The amount of said loss and that it was sustained on a *sale* of property were stipulated (R. 34).

which no gain or loss shall be recognized under either Section 112(b)(3) or 112(b)(4) of said Code.

The pertinent facts are as follows:[2]

Petitioner was a whiskey distiller. By the beginning of 1948 the whiskey market was greatly oversupplied, whiskey prices had fallen drastically, and the petitioner, lacking an established label or a large supply of old whiskey, was faced with ruinous competition. Petitioner's shareholders therefore adopted at a meeting held on January 5, 1948, resolutions (a) to discontinue the petitioner's business and liquidate and dissolve, (b) to sell petitioner's real property consisting of its distilling and rectifying plants and administrative offices, including the equipment therein, at public auction and (c) to distribute pro rata to petitioner's shareholders the proceeds from such sale and whatever other cash might be left over, together with whiskey warehouse receipts representing part of petitioner's inventory of bulk whiskey.

On May 13, 1948, one week before the aforementioned auction was to be held, and approximately four and a half months after the aforementioned resolutions were adopted, petitioner's principal shareholders[3] agreed to organize the Old Peoria Building Corporation, hereinafter called Old Peoria, with $1,000 of capital stock to be paid for and issued to them in proportions widely disparate to their combined equity interests in the petitioner[4]. At the same time said

2. Except as otherwise indicated all of said facts are from the opinion of either the Tax Court or the Court of Appeals, Appendix B, *infra*, pages 23-41.

3. Consisting of individuals in three unrelated family groups who owned, in the aggregate, 75.9% of petitioner's outstanding stock. The remaining 24.1% of petitioner's stock was owned by 657 shareholders none of whom was related to any of the petitioner's principal shareholders or to each other.

4. Of all of petitioner's stock owned by its principal shareholders the Silberstein family owned 46.2%, the Venezky family 47.2% and the Weiner family 6.6%. Said families owned 35%, 35% and 30%, respectively, of the stock of Old Peoria.

principal stockholders agreed that a bid of $242,080 would be made at the auction on behalf of Old Peoria for petitioner's noninventory assets if, but only if, no other bidder offered at least that amount.

The auction was duly held, as advertised, on May 20, 1948, and although many persons were present, including persons other than petitioner's principal shareholders, the only bidder was Robert L. Silberstein, petitioner's president, who as nominee for Old Peoria bid $242,080. The petitioner, having reserved the right of acceptance or rejection, accepted said bid on June 9, 1948, and on June 15, 1948, petitioner conveyed the auctioned property to Old Peoria, by warranty deeds and bill of sale, upon payment by Old Peoria to the petitioner of $194,208.36 in cash and the assumption by Old Peoria of mortgage and real estate tax liabilities of $47,871.64, *i. e.*, the difference between said cash payment and the amount bid. Petitioner sustained a loss of $551,428.54 on said sale.

Old Peoria borrowed $200,000 with which to pay the petitioner for said property, $70,000 or 35% thereof from a corporation all of the stock of which was owned by members of the Silberstein family, the same amount from a corporation all of the stock of which was owned by members of the Venezky family, and $60,000 or 30% thereof from a corporation all of the stock of which was owned by members of the Weiner family (R. 46).

All of the acts called for in the resolutions adopted at the January 5, 1948, meeting of petitioner's shareholders were duly carried out, including distribution by the petitioner of liquidating dividends in kind consisting of whiskey warehouse receipts and script therefor, and a series of cash liquidating distributions. Petitioner was dissolved on November 15, 1950.

Between May 20, 1948, the date of the auction, and June 15, 1948, when the petitioner conveyed and delivered its

noninventory assets to Old Peoria, petitioner's principal shareholders endeavored to find a buyer for such property who would purchase it—not from Old Peoria or from petitioner's principal shareholders—but from the petitioner itself, for an amount in excess of $242,080, but they were unsuccessful in finding such a purchaser (R. 26-27). The only use which Old Peoria ever made of the property it purchased from the petitioner was to rent out space therein for dead storage, and its rental income has never equalled its expenses (R. 48).[5]

REASONS FOR GRANTING THE WRIT

I. The Decision of the Court Below Is in Direct Conflict With Legal Principles Enunciated by the Second Circuit Court of Appeals and Approved by This Court. It Is Also in Conflict With the Opinion of the United States Court of Appeals for the Sixth Circuit in the Case of United States v. Arcade Company (6th Cir.—1953), 203 F. (2d) 230, and the Opinion of the United States Court of Appeals for the Fifth Circuit in the Case of Scofield v. San Antonio Transit Company (5th Cir.—1954), 219 F. (2d) 149.

5. The Court of Appeals apparently thought, although all of the evidence is to the contrary, that petitioner's principal shareholders intended to continue in the distilling business, through Old Peoria. That this cannot possibly be so is clear from (a) what Old Peoria actually did with the property it purchased from the petitioner, (b) no distiller could ever operate on merely $50,000 of business a year, (c) Old Peoria had no operating capital whatever, (d) Old Peoria had no whiskey licenses, (e) small distillers could no longer compete with established labels and (f) both the petitioner and its principal shareholders were doing everything they could possibly do to get out of the whiskey business. Moreover, those portions of the opinion below which refer to the Old Peoria preorganization subscription agreement and to Old Peoria's charter collide directly with the established rule that questions of taxation must be determined on the basis of what was actually done rather than what was said. *Helvering* v. *Tex-Penn Oil Co.* (1937), 300 U. S. 481; *Weiss* v. *Stearn* (1924), 265 U. S. 242.

Albeit on slightly different facts but still in relation to an identical issue, *i. e.*, whether assets were transferred pursuant to a tax free reorganization, the Honorable Circuit Judge Augustus N. Hand said in *Cortland Specialty Co.* v. *Commissioner* (2d Cir.—1932), 60 F. (2d) 937, at p. 939, that:

> "Reorganization, merger, and consolidation are words indicating corporate readjustments of existing interests. They all differ fundamentally from a sale where the vendor corporation parts with its interest for cash and receives nothing more. * * * While the term [reorganization] includes financial readjustments in ways other than by judicial sale, *it does not properly embrace mere purchases by one company of the assets of another.*" (Italics added for emphasis.)

This Court cited said case with approval in *Pinellas Ice & Cold Storage Co.* v. *Commissioner* (1933), 287 U. S. 462. Those cases are highly significant because, although they dealt with Section 203 of the Revenue Act of 1926, said section in all material respects is identical with Section 112 of the 1939 Code. Moreover, although the *Cortland* and *Pinellas* cases dealt with the question as to whether a reorganization resulted from a merger or consolidation within the meaning of Section 203(h)(1)(A) of the Revenue Act of 1926 (Section 112(g)(1)(A) of the Internal Revenue Code of 1939), the legal principles above set forth from the opinion of Judge Hand were expressly stated by him to apply to reorganizations as well as to mergers and consolidations. And that he was correct in this regard is evident from the fact that a merger or consolidation is simply one type of reorganization under Section 112(g) of the 1939 Code; a transfer under Section 112(g)(1)(D) of said Code is simply another type of reorganization under the same section. A careful reading of Judge Hand's opinion in the *Cortland* case and the opinion of this Court in the *Pinellas* case indicates that if

the instant case had been heard by this Court, or by Judges Learned Hand, Augustus N. Hand and Chase of the Second Circuit (the panel which decided the *Cortland* case) both of said courts would have held that there was merely a sale for cash here and not a tax free reorganization.

That the opinion of the Court of Appeals in the present case is in direct conflict with *United States* v. *Arcade Company, supra,* is evident from a mere reading of that case. The *Arcade Company* opinion is printed in Appendix C, page 42, *infra.*[6] And that the opinion below is also in conflict with *Scofield* v. *San Antonio Transit Company*[7] is evident from the following excerpt from the court's opinion in that case, 219 F. (2d) l. c. 154-155:

> "When the Tower building was transferred to the taxpayer only the shell of the old corporation was left; the business enterprise which it had represented no longer existed; * * *.

6. The issue in Arcade Company, as in the present case, was whether there was a tax free reorganization under Sections 112 (b)(4) and 112(g)(1)(D) of the 1939 Code. The Sixth Circuit held there was not because, *inter alia,* (1) none of the elements of a reorganization, as set forth in the regulations, existed, (2) neither the old nor the new corporation adopted a plan of reorganization, (3) none of the old corporation's stockholders was bound to form a new corporation, (4) the new company was a different and separate enterprise from the old and (5) the formation of a new corporation was not dependent on any plan of reorganization nor related in any manner to a plan of reorganization. *Each of these circumstances is also present in the instant case.* The *Arcade Company* case is not even mentioned in the opinion below. The Tax Court referred to it as distinguishable on the narrow ground of an intervening transfer of assets by the old corporation to trustees for its stockholders who immediately thereafter transferred the very same assets to the new corporation in exchange for the latter's stock, issued pro rata to the old corporation's shareholders. Aside from the obvious and important fact that this distinction is one merely of form and not of substance, the same factual distinction was deemed irrelevant in *Survaunt* v. *Commissioner,* (8th Cir.—1947), 162 F. (2d) 753. Hence the *Arcade Company* opinion is not distinguishable from the instant case; instead it clearly is in conflict therewith.

7. This case is not mentioned anywhere in the opinion of either the court below or the Tax Court.

> "We * * * hold that * * * where the [transferee] acquired what amounts to only one property of a substantial enterprise as a result of proceedings and activities completely separate from all other property * * *, the necessary continuity of interest is not shown. Under no reasonable view can it be said that the old corporation has emerged as substantially the same enterprise in new form."

Just so, when petitioner's noninventory assets were sold to Old Peoria "only the shell of [the petitioner] was left; the business enterprise which it had represented no longer existed". And equally so, Old Peoria in the instant case purchased less than six and a half per cent in value of petitioner's assets. Hence, if the federal tax laws are to be applied uniformly among the circuits, what the Fifth Circuit Court said in *San Antonio Transit Company* must be equally true here, *i. e.*, "under no reasonable view can it be said that the old corporation has emerged as substantially the same enterprise in new form."

II. An Important Question of Federal Law Not Heretofore Decided by This Court Is Involved.

The question involved in this case is important because it is well known that property is sold every day by one corporation to another where the stock of both corporations is owned by the same or substantially the same individuals. It has never been suggested heretofore that such sales constitute exchanges pursuant to tax free reorganizations except in those situations where the sales obviously were mere sham transactions, as in *Heller* v. *Commissioner* (9th Cir.—1945), 147 F. (2d) 376, and *Survaunt* v. *Commissioner, supra.* (Cf. *Liddon* v. *Commissioner* (6th Cir.—1956), 230 F. (2d) 304, petition for a writ of certiorari (No. 953, October Term, 1955) filed May 18, 1956, in which the new corporation continued to operate exactly

the same business as the old, even to the extent of taking over the old corporation's employees' retirement fund). On the contrary both the Internal Revenue Service and taxpayers have always been led to believe on the basis of the statutes themselves, long standing regulations, and court decisions, that a sale is not an exchange.[8]

Moreover, the question involved in this case must be definitely answered by this Court if almost endless litigation is to be avoided since the opinion below raises many unanswered questions, not only in relation to the present petitioner, Old Peoria, and the shareholders of both, including petitioner's 657 public shareholders, but in all other cases involving sales between related corporations. Among them, in addition to the question discussed at p. 17, *infra*, as to whether the opinion below judicially amends Section 24(b)(1)(C) of the 1939 Code and Section 267(b)(3) of the 1954 Code, are questions as to (a) the basis for depreciation and gain or loss to the purchasing corporation of property purchased for cash from a related corporation, (b) the basis to the shareholders of the purchas-

8. The cases of *Becher* v. *Commissioner* (1954), 22 T. C. 932, aff'd. (2d Cir.—1955), 221 F. (2d) 252, and *Morley Cypress Trust* v. *Commissioner* (1944), 3 T. C. 84, strongly relied upon in the opinions of the Tax Court and the Court of Appeals in the instant case, each involved a pro rata exchange of stock for stock. That is a far cry from a bona fide arm's length sale solely for cash of real estate and equipment which the petitioner could neither use (because it was going out of business) nor distribute pro rata to 660 separate shareholders as tenants in common. Moreover, said property had an adjusted basis to the petitioner of $793,508.54 (R. 30), and its fair market value (as evidenced by the amount bid at public auction) was only $242,080. Sound business judgment dictated a sale to assure petitioner the tax benefits resulting therefrom, a circumstance which certainly does not justify the conclusion that a transaction which was a sale in fact as well as in form should be regarded as an exchange of stock for stock or assets for stock. See, *e. g. Sun Properties, Inc.* v. *United States* (5th Cir.—1955), 220 F. (2d) 171, 173-175. The controverted deduction would not have been disallowed if the sale had been to a "stranger." Why should there be a different result on the arm's length cash sale to Old Peoria?

ing corporation of their stock therein, (c) whether a selling corporation's liquidating distributions are taxable to its stockholder-distributees as ordinary income or capital gains, (d) the status, so far as transferee liability is concerned, of petitioner's public shareholders and other taxpayers similarly situated, and (e) the status so far as transferee liability is concerned of taxpayers such as Old Peoria which, although it acquired property from the petitioner for a full and adequate consideration, *i. e.*, by cash purchase, nevertheless might be charged as a transferee for petitioner's tax liability because the court below held that although Old Peoria purchased said property, it still acquired it not by purchase but pursuant to a tax free reorganization.

Another important reason why the question involved herein should be resolved by this Court is to dispel the confusion that exists in the courts, in the minds of taxpayers, and in the Internal Revenue Service, as to whether straight cash sales do or do not constitute exchanges within the meaning of the nonrecognition provisions of the tax laws. One example of the confusion surrounding this issue appears in the split opinion of the Sixth Circuit in *Liddon* v. *Commissioner, supra.* In the dissenting opinion in that case it is stated that it was *admitted*, presumably by the majority of the Court, that the tax free reorganization claim there presented could *not* have been maintained if the new company had conducted exactly the same kind of business as the old company, *i. e.*, an automobile dealership, but with a different make of car. In other words, *Liddon* was decided as it was because both the old and the new corporations were Pontiac dealers. If the new company had been a Ford dealer the Sixth Circuit would have held that there was *not* a tax free reorganization even though both corporations had substantially the same shareholders. Since the new company here (Old Peoria) has

never been in the whiskey business, it is clear that the Sixth Circuit would have decided the instant case for the petitioner if the case had been before that Court.

Another example of the confusion surrounding the question involved in the present case is that the Commissioner did not even suggest the possibility of a tax free reorganization until the very day of the Tax Court trial. Said contention was not presented in February of 1950, when the original report of examination was prepared (R. 11-14); it was not raised in the statutory notice of deficiency, none of the subsections of Section 112 of the 1939 Code being mentioned anywhere therein (R. 7-11); and it was not raised in the Commissioner's answer before the Tax Court (R. 14-15). It obviously was presented at the last minute in an effort to save what must have been regarded as a losing case.[9] That the Internal Revenue Service is hopelessly confused as to whether a sale is or is not an exchange within the meaning of the nonrecognition sections of the 1939 and 1954 Codes is also evident from the regulations and rulings cited in footnotes 10 and 11, pages 14 and 15, *infra*, which regulations and rulings are diametrically opposed to the position asserted by the Commissioner in this very case.

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9. The only position maintained by the Commissioner prior to the Tax Court trial was that Sections 24(b)(1)(B), 24(b)(2)(C) and 3797(a) of the 1939 Code require disallowance as a deduction of the loss which petitioner sustained (R. 13). This contention was also presented to the Tax Court as the Commissioner's principal argument (R. 69), but it was not passed upon (R. 70). It was rejected by implication, however, by virtue of the Tax Court and Court of Appeals finding of fact that petitioner sold its non-inventory assets to a corporation.

III. There Has Been Such a Radical Departure from Customary and Accepted Standards of Judicial Review as to Call for the Exercise by This Court of Its Supervisory Powers.

It is submitted, for the reasons hereinafter set forth, that the opinion of the Court of Appeals is so clearly wrong as to call for the exercise by this Court of its powers of supervision.

A. Congress has by unequivocal statutory language made an exchange of assets for stock, or stock for stock, the *sine qua non* of a tax free reorganization. Sections 112(b) (3) and 112(b) (4), Internal Revenue Code of 1939. Yet nowhere in the opinion below or in the Tax Court opinion did either of said courts find an exchange of any kind, let alone an exchange of assets for stock, or stock for stock. Indeed no such finding was possible because it would be contrary to the finding by both courts that Old Peoria purchased property from the petitioner for cash. Old Peoria's position, *vis a vis* the petitioner and its noninventory assets, was exactly the same as any other purchaser's would have been, *i. e.*, petitioner's principal shareholders acquired their equity interests in petitioner's noninventory assets, through their ownership of Old Peoria stock, by purchase and not because or by virtue of their ownership of any of the petitioner's stock. As stated in *Mascot Stove Co.* v. *Commissioner* (6th Cir.—1941), 120 F. (2d) 153, at p. 155,

> "There was * * * no exchange of stock for stock, or property for stock, and the interest the stockholders acquired in the new company was not, either in legal contemplation or as an economic concept, an acquisition in exchange for their stock in the old company, or by virtue of their ownership of it."

Under these circumstances the holding of the Court of

Appeals that petitioner transferred assets to Old Peoria pursuant to a tax free reorganization not only misinterprets applicable and controlling statutes—it disregards them entirely.

B. If it can be said that the Court of Appeals did not disregard Sections 112(b) (3) and 112(b) (4) of the Internal Revenue Code of 1939 but instead held that petitioner's assets were transferred in a transaction involving an exchange of assets for stock, or stock for stock, such holding could only have been on the theory that the terms "sale" and "exchange" are synonymous. If this was the reasoning of the Court below, a matter which it is impossible to determine from the opinion itself, then the Court ignored controlling regulations to the same extent as though they were nonexistent, even though such regulations have the force and effect of law because they repeatedly have been reissued without change while the statutes to which they relate have been reenacted without change. Said regulations expressly provide (a) that "* * * a sale is nevertheless to be treated as a sale even though the mechanics of a reorganization have been set up",[10] and (b) that "The term [reorganization] does not embrace the mere purchase by one corporation of the properties of another corporation * * *. If the properties are transferred for cash * * * the transaction is a sale and not an exchange."[11]

10. Section 19.112(g)-1, Regs. 103, promulgated August 23, 1939; Section 29.112(g)-1, Regs. 111, issued October 26, 1943; the last named section as amended by T. D. 5402 and T. D. 5990, issued September 15, 1944, and February 17, 1953, respectively; Section 39.112(g)-1, Regs. 118, promulgated September 23, 1953; and Section 1.368-1, T. D. 6152, issued November 25, 1955, as part of the final regulations applicable to Section 368 of the Internal Revenue Code of 1954.

11. Section 19.112(g)-2, Regs. 103, issued August 23, 1939; Section 29.112(g)-2, Regs. 111, issued October 26, 1943; the last named section as amended by T. D. 5990, issued February 17,

Moreover, as long ago as 1922, in discussing a comparable section of the Revenue Act of 1921, the Commissioner of Internal Revenue expressly ruled that "To constitute an exchange * * * [a] transaction must be a reciprocal transfer of property for property as distinguished from a transfer of property for a money consideration." I. T. 1410, C. B. I-2, p. 25. And in 1927 the Bureau of Internal Revenue ruled that "A sale is a transfer of property * * * in consideration of a sum of money, as opposed to [an] exchange * * *". G. C. M. 1977, C. B. VI-2, p. 168. Neither of these rulings has ever been modified or withdrawn.

When such long standing regulations and rulings are wholly disregarded by a Court of Appeals, this Court should grant Certiorari to review and correct the opinion of that Court of Appeals.

C. With all due respect it is submitted that the opinion below violates all rules of logic by attributing a statutory tax rule relating to recognition or nonrecognition of gain or loss to a section of the Code which merely defines the word "reorganization", and which has nothing whatever to do with the matter of recognition or nonrecognition of gain or loss. Section 112(g) (1) (D) of the Internal Revenue Code of 1939 defines the term "reorganization" to mean, *inter alia*, "a transfer by a corporation of * * * a part of its assets to another corporation if immediately after the transfer [the shareholders of] the transferor * * * are in control of the [transferee] corporation * * *". However said section does not provide that such a reorganization is or is not tax free; in fact, it has nothing whatever to do with whether gain or loss is or is not to be

1953; Section 39.112(g)-2, Regs. 118, promulgated September 23, 1953; and Section 1.368-2, T. D. 6152, promulgated November 25, 1955, as part of the final regulations applicable to Section 368 of the Internal Revenue Code of 1954.

recognized on such a reorganization. The determination of that question depends, so far as the present case is concerned, on Sections 112(b) (3) and 112(b) (4) of the Internal Revenue Code of 1939.[12] In the opinion below the Court stated, unequivocally, that there can be "a tax free reorganization under Section 112(g) (1) (D) of the [1939] Code." The same court referred to the instant case in a similar manner more recently in *Goldstein Bros., Inc.* v. *Commissioner* (7th Cir.—1956), 232 F. (2d) 566. Such thinking, which obviously influenced the Court below in deciding the instant case as it did, and perhaps was even determinative in causing the Court to arrive at its decision, is clearly erroneous. Such error undoubtedly will be committed by other trial and appellate courts on the authority of the opinion below if it is not rectified.[13]

12. The Tax Court found a tax free reorganization under Sections 112(b)(3) and 112(g)(1)(D) of the 1939 Code (R. 70). The Court of Appeals, by affirming the Tax Court, apparently made the same finding. However, Section 112(b)(3) proscribes recognition of gain or loss only to taxpayers exchanging stock for stock. Even if it could be said, contrary to the facts, that such an exchange occurred, then the parties thereto would have had to be the petitioner's principal shareholders and Old Peoria. But it is the petitioner's loss that is involved in this case and the petitioner could not have exchanged any of its stock for Old Peoria stock, even constructively. Hence, Section 112(b)(3) is clearly inapplicable and resort must be had to Section 112(b)(4), which deals expressly with recognition of gain or loss to a corporation which exchanges property solely for stock or securities in another corporation a party to a reorganization. The petitioner, since it sold property to Old Peoria solely for cash, did not and could not have exchanged said property solely for Old Peoria stock or securities. And neither the Tax Court nor the Court of Appeals so found. Therefore, the instant case really does not fall within the ambit of either Section 112(b)(3) or 112(b)(4) of the Internal Revenue Code of 1939.

13. This view, that nonrecognition of gain or loss depends only on fulfilling the requirements of the statutory definition of the term "reorganization" may be based, in part at least, on language contained in opinions such as *Helvering* v. *Alabama Asphaltic Limestone Company* (1942), 315 U. S. 79, and *Helvering* v. *Southwest Consolidated Corporation* (1942), 315 U. S. 194, in each of

D. The opinion below also stands for the erroneous proposition that in computing corporate net income no deduction will ever be allowed in respect of losses from sales of property between two corporations substantially all of the stock of each of which is owned by the same individuals because, according to the Court of Appeals, the invariable result of such sales will always be tax free reorganizations. However, Section 24(b) (1) (C) of the Internal Revenue Code of 1939 proscribes the deduction of such losses only if either the buying or selling corporation was a domestic or a foreign personal holding company during its taxable year preceding the date of the sale. Neither the petitioner nor Old Peoria was ever a personal holding company, foreign or domestic. Hence, the effect of the opinion below is to amend Section 24(b) (1) (C) of the Internal Revenue Code of 1939 (and Section 267(b) (3) of the Internal Revenue Code of 1954), so that losses from sales of property between two corporations, a majority of the stock of each of which is owned by the same individuals, will *always* be nondeductible whether or not either corporation was a domestic or foreign personal holding company during its taxable year preceding the date of the sale. Such amendment of the statute by judicial decision is wholly improper and calls for review by this Court.

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which the only question presented was whether there was a reorganization. It apparently was not necessary to discuss or consider the nonrecognition subdivisions of the reorganization sections involved in either of those cases because nonrecognition of gain or loss must have been conceded (or no issue raised in respect thereof) if the Court found that a reorganization occurred within the meaning of the statutory definition of that term. Because of this circumstance the erroneous position of the Court of Appeals in the instant case already may have been "perpetuated" to some extent. See, for example, in addition to the instant case, the case of *Survaunt* v. *Commissioner*, *supra*, l. c. 754. Hence, there is a need for this Court to clarify its "reorganization" comments.

IV. The Opinion Below Does Not Reach or Answer the Real Issue in Controversy. Review by This Court Is Therefore Necessary to Remove the Misunderstandings Which the Opinion Below Will Engender.

Conceded facts which are decisive but which the Tax Court and the Court of Appeals completely ignored (so far as can be determined from their opinions) are as follows: (1) the petitioner sold for cash only a very small part of its assets; (2) the proceeds of said sale were distributed, together with all of petitioner's other net assets, to all 660 of the petitioner's shareholders in complete liquidation of the petitioner, and no part of any of such assets went into Old Peoria; (3) the only reason petitioner's noninventory assets were sold to Old Peoria rather than to a "stranger" was that no one else offered to buy them before the auction, at the auction, or thereafter, although efforts were made by the petitioner at all three of said stages to find an "outside" purchaser; (4) Old Peoria was formed with new money—$1,000 of paid in capital and $200,000 which it borrowed from three corporations none of which owned any of the petitioner's stock, directly or indirectly; and (5) the matter of a reorganization or continuation of the petitioner in modified corporate form, or any other form, was never suggested, discussed or even considered by the petitioner or Old Peoria, or by any of the shareholders of either of them.[14]

Deductibility of the loss petitioner sustained on the sale of its noninventory assets could not have been questioned if the sale (even a private sale) had been to either the Silberstein or Venezky family members alone.[15] Now, be-

14. See, in this connection, 3 Mertens Law of Federal Income Taxation, Section 20.50, p. 183.

15. Each of which as a unit owned approximately 35%, *i. e.*, less than 50%, of petitioner's outstanding stock. See Section 24(b)(1)(B), Internal Revenue Code of 1939.

cause the subterfuge of a sale to one of the petitioner's officers was *not* used,[16] the Internal Revenue Service, the Tax Court and the United States Court of Appeals for the Seventh Circuit have denied to the petitioner the loss deduction to which it clearly is entitled by law. Such attitude places a premium on subterfuge; it exalts form over substance; and it places the already complex field of federal income tax law in the realm of fantasy rather than reality.

All of the foregoing arguments, in addition to numerous others, were presented to the court below (1) in the taxpayer's original and reply briefs, (2) in the taxpayer's petition for rehearing, and (3) on oral argument. However, not a single comment appears anywhere in the opinion below concerning any of them. Hence said opinion leaves this taxpayer, its 657 public shareholders (all of whom may be involved as transferees in prolonged litigation because of said opinion), the taxpayer's attorneys, counsel for each of the taxpayer's public shareholders, and all other taxpayers, lawyers, accountants, Internal Revenue Service personnel and any others who may pause to read, in the anomalous position of not knowing (1) why the court below decided the instant case as it did, (2) why the rationale of the *Cortland* and *Pinellas* cases is inapposite, (3) whether the law on tax free reorganizations now is as stated in the *Arcade Company* and *San Antonio Transit Company* cases, *supra*, or as stated by the court below in the instant case, (4) whether the rule now is, notwithstanding statutes and regulations expressly to the contrary, that a tax free reorganization occurs on every corporate sale of property for cash, even though there is not an exchange either of assets for stock or stock for

16. If such sale had been made, say to Silberstein, he could have sold 35% and 30% of his interest to the Venezky and Weiner families, respectively, some two to five years later.

stock, whenever the shareholders of the selling and purchasing corporations are substantially the same and (5) whether, as pointed out at page 17, *supra,* Sections 24(b)(1)(C) and 267(b)(3) of the Internal Revenue Codes of 1939 and 1954, respectively, have been amended by judicial decision.

CONCLUSION

For the foregoing reasons this Petition for a Writ of Certiorari should be granted.

Respectfully submitted,

CLAUDE A. ROTH,
SIDNEY U. HIKEN,
BENJAMIN M. BRODSKY,
BERNARD WEISBERG,
Counsel for Petitioner.

Dated: June 29, 1956.

APPENDIX A

INTERNAL REVENUE CODE OF 1939.

"SEC. 112. RECOGNITION OF GAIN OR LOSS.

* * * * *

"(b) Exchanges Solely in Kind.—

* * * * *

"(3) Stock for stock on reorganization.—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

"(4) Same—gain of corporation.—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

* * * * *

"(g) Definition of Reorganization.—As used in this section * * *—

"(1) The term 'reorganization' means * * * (D) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its shareholders or both are in control of the corporation to which the assets are transferred * * *."

"SEC. 24. ITEMS NOT DEDUCTIBLE.

* * * * *

"(b) Losses from Sales or Exchanges of Property.—

"(1) Losses disallowed.—In computing net income no deduction shall in any case be allowed in respect of losses from sales or exchanges of property, directly or indirectly—

* * * * *

"(C) Except in the case of distributions in liquidation, between two corporations more than 50 per centum in value of the outstanding stock of each of which is owned, directly or indirectly, by or for the same individual, if either one of such corporations, with respect to the taxable year of the corporation preceding the date of the sale or exchange was, under the law applicable to such taxable year, a personal holding company or a foreign personal holding company;

* * * * *"

APPENDIX B

PEBBLE SPRINGS DISTILLING CO.,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket No. 40519. Filed October 29, 1954.

During the course of a liquidation which commenced in 1948, petitioner sold all of its noninventory assets to a corporation wholly owned by its controlling stockholders. The new corporation had broad powers to carry on the same business as petitioner as well as to conduct a real estate and other businesses. It rented the property to various tenants and was still in existence at the time of the hearing. The price at which the noninventory assets were sold was $551,428.54 less than their depreciated book value. Petitioner claimed a net operating loss on its return for the fiscal year ended March 31, 1949, and carried such loss back to its two preceding taxable years. Carry-back of the loss eliminated all taxes for those years.

Held, the purchase of petitioner's noninventory assets by a corporation wholly owned by petitioner's controlling stockholders was pursuant to a plan of reorganization within the meaning of section 112 (g) (1) (D) of the 1939 Code; hence, no loss is allowed on such sale.

Sidney U. Hiken, Esq., for the petitioner.

Robert R. Veach, Esq., for the respondent.

This proceeding involves deficiencies in income tax of $110,030.86 for the fiscal year ended March 31, 1947, and $34,128.81 for the fiscal year ended March 31, 1948.

Appendix B

The only issue is whether petitioner sustained a recognized loss on the sale of its plant and other noninventory assets during the taxable year ended March 31, 1949, which may be carried back as a net operating loss to its two previous taxable years.

Some of the facts were stipulated.

Findings of Fact.

The stipulated facts are so found, and are incorporated herein by this reference.

Petitioner, a whiskey distiller, was incorporated under the laws of Illinois on July 25, 1945. Its offices and principal place of business were located at Peoria during the years here in issue. It began business in the spring of 1946, and kept its books and filed its returns for the fiscal years ended March 31, 1947, 1948, and 1949, on the accrual basis with the collector of internal revenue for the eighth district of Illinois.

Petitioner had 500,000 outstanding shares of stock owned by the following persons (hereinafter sometimes referred to as the controlling stockholders) who, as indicated, were its officers and directors and related to one another:

Stockholder	Officer or Relationship	Number of Shares Owned	% of Shares Owned
Robert L. Silberstein	President (hereinafter referred to as Silberstein)	58,534	
Helen E. Silberstein	Wife of Robert	58,633	
Willard Silberstein	Brother of Robert	58,333	
Julian B. Venezky	Secretary and Treasurer	62,322	
Madelynn Venezky	Wife of Julian	58,433	
Bernard Venezky	Brother of Julian	58,333	
Lewis P. Weiner	Vice-President	25,000	
Kathryn R. Weiner	Wife of Lewis	100	
		379,688	75.9
657 Public Shareholders		120,312	24.1
	Total	500,000	100.0

Appendix B

By the beginning of 1948, the whiskey market was greatly oversupplied. Production had been substantially increased following the war, and distillers and dealers were overstocked; prices had declined drastically. Companies, such as petitioner, without an established label or a large supply of old whiskey were faced with ruinous competition.

At a shareholders' meeting on January 5, 1948, petitioner's president reported the outlook facing the company and stated that its directors felt that operations could continue only if it were willing to expend substantial sums in advertising and for the purchase of older whiskeys. He further reported that the necessary funds for such expenditures were not available and recommended, in behalf of the directors, that the company be dissolved. Petitioner's shareholders thereupon authorized its directors to dissolve the corporation and liquidate its assets. They further authorized the directors to sell petitioner's plant and other real property at public auction and to distribute the proceeds from such sale, together with other assets or their cash equivalent, *pro rata* to the stockholders. Petitioner's president also stated at the meeting that negotiations with two of the major distilleries looking toward a purchase by one of them of all of petitioner's outstanding stock had not been successful.

In January 1948, when dissolution was authorized, petitioner had a bulk whiskey inventory of approximately 2,000,000 gallons. Such inventory had a cost or book value of approximately $1,700,000 and a fair-market value of approximately $3,400,000. On April 9, 1948, petitioner's directors authorized a *pro rata* distribution of a part of its whiskey inventory to its stockholders. Pursuant thereto, approximately 1,000,000 gallons of whiskey were so distributed by the medium of warehouse receipts, and script where a stockholder held less than 200 shares. The inventory accounts on petitioner's books were credited with the

cost value of the whiskey, in the amount of $981,921.23. The fair-market value of the whiskey so distributed was approximately $2,010,000.

Also on April 9, 1948, petitioner's directors authorized the firm of Samuel L. Winternitz & Co. to auction petitioner's plant, fixtures, machinery, good will, labels, and brand names, such auction to be held on petitioner's premises on May 20, 1948.

All of petitioner's stockholders were so notified, and advertisement of the auction appeared in several newspapers.

The brochure prepared by the auctioneer specified that the highest bidder would be required to deposit 10 per cent of the price bid, in cash or by certified check.

At a meeting on May 13, 1948, one week prior to the auction, petitioner's controlling stockholders, headed by Silberstein, its president, decided that they would purchase all of petitioner's assets at the auction for the sum of $242,080 if no bid of that amount or more was made by someone else. Also on that day, the controlling stockholders began organizing a corporation which they intended would purchase and receive title to such assets. Because the name chosen for the new corporation was not available, issuance of its charter was delayed until June 5, 1948. On that date, the new corporation—Old Peoria Building Corporation—(hereinafter referred to as Old Peoria) was granted a perpetual charter by the State of Illinois and empowered to buy, sell, own, rent, lease, hold, convey, and mortgage real estate and any interest therein; to carry on any business commonly conducted by real estate developers; to acquire, hold, and dispose of patents and trademarks; to buy and sell any and all equipment and merchandise used in manufacturing or commercial operations; and to manufacture, buy, sell, deal in, distribute, store, warehouse and export whiskey of all kinds, high

wines, spirits, alcohol and gins of all kind and to do and perform all kinds of distilling, redistilling and rectifying high wines, spirits and alcohol and of compounding and blending of gins and whiskies of all kinds. Old Peoria's stock was wholly owned by petitioner's controlling stockholders at all times here material.

At the auction on May 20, 1948, the auctioneer divided the assets into four lots: (1) good will, (2) rectifying and bottling plant, (3) distillery, and (4) entire plant and good will (lots 1, 2, and 3).

While persons other than the controlling stockholders were present at the auction, they made no bids. When lot 3 was offered, Silberstein bid $40,000; and when lot 4 was offered, he bid $242,080 as he and the other controlling stockholders had agreed. The auctioneer recited the customary first, second, and third call—"Going, going, gone" —and declared all of petitioner's assets "Sold" to Silberstein.

The auctioneer's memorandum of the sale showed that all of the property was bid for and sold for $242,080 to Silberstein, "his nominee or nominees". Silberstein, as petitioner's president, together with its other officers waived the 10 per cent deposit requirement.

On June 9, 1948, petitioner's board of directors ratified the May 20 auction sale of its assets, and on June 15 petitioner transferred such assets to Old Peoria upon payment by it of cash in the amount of $194,208.36 and the assumption of two mortgages and taxes. Old Peoria had previously secured a loan of $200,000 from three corporations owned by the Silberstein, Venezky, and Weiner families, respectively.

Subsequent to the purchase of the assets, Old Peoria rented parts of the plant to some 20 or 25 different tenants for dead storage. It was still in business at the time of the hearing.

Appendix B

Petitioner declared a second liquidating dividend of 40¢ per share on June 9, 1948; a third such dividend of 10¢ per share on April 6, 1949; a fourth of 5¢ per share on September 2, 1949; and a final such dividend of 21¢ per share on May 5, 1950. It was finally dissolved on November 15, 1950.

On its income tax return for the fiscal year ended March 31, 1947, petitioner reported net taxable income of $289,328.83 and income tax liability thereon of $109,905.95. On its return for the fiscal year ended March 31, 1948, it reported net taxable income of $89,812.66 and income tax liability thereon of $34,128.81.

The depreciated book value of petitioner's noninventory assets sold by public auction on May 20, 1948, was $793,508.54. On its return for the fiscal year ended March 31, 1949, petitioner showed an operating profit of $10,376.33 and a net loss of $561,982.32. It claimed a loss of $551,428.54 from the auction sale of its assets and a net operating loss for the taxable year of $551,605.99 which it carried back to the two preceding taxable years. Petitioner therefore claimed, and received, a refund of taxes paid in 1947 and 1948 in the respective amounts of $109,905.95 and $34,128.81.

In his deficiency notice, respondent determined that:

> * * * no net operating loss deduction is allowable under the provisions of Sections 23(s) and 122 of the Internal Revenue Code for the years ended March 31, 1947 and 1948, by reason of the sale or transfer of taxpayer's properties during the year ended March 31, 1949.

Petitioner's sale of its noninventory assets to Old Peoria was pursuant to a plan of reorganization within the provisions of section 112 (b) (3) and (g) (1) (D) of the Internal Revenue Code of 1939, and no loss is, therefore, recognized on such sale.

Appendix B

Opinion.

Rice, *Judge:* Respondent predicated his disallowance of the claimed net operating loss carry-back here on three grounds: (1) that the sale of petitioner's noninventory assets was, in fact, made to Silberstein as representative of the controlling stockholder group, and that any loss thereon is barred by section 24 (b) (1) (B)[1] of the 1939 Code; (2) that if the sale was, in fact, made to Old Peoria, petitioner's transfer of its assets was pursuant to a plan of reorganization within the provisions of section 112 (b) (3) and (g) (1) (D)[2] and no loss is, therefore, recognized; and (3) that in any event, petitioner suffered no real economic loss

---

1. Section 24. *Items Not Deductible.*

* * * * *

(b) Losses from Sales or Exchanges of Property.—

(1) Losses Disallowed.—In computing net income no deduction shall in any case be allowed in respect of losses from sales or exchanges of property, directly or indirectly—

* * * * *

(B) Except in the case of distributions in liquidation, between an individual and a corporation more than 50 per centum in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual;

2. Section 112. *Recognition of Gain or Loss.*

* * * * *

(b) Exchanges Solely in Kind.—

* * * * *

(3) Stock for Stock on Reorganization.—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

* * * * *

(g) Definition of Reorganization.— * * *

(1) The term "reorganization" means * * * (D) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its shareholders or both are in control of the corporation to which the assets are transferred, * * *

sufficient to constitute a "net operating loss" within the meaning of section 122.

Whatever the merits of respondent's positions enumerated as (1) and (3) above, it is clear that the purchase of petitioner's noninventory assets by a corporation wholly owned by petitioner's controlling stockholders was pursuant to a plan of reorganization within the provisions of section 112 (b) (3) and (g) (1) (D). The substance of petitioner's argument is that the sale of its noninventory assets was incident only to its own liquidation, and not pursuant to any plan of reorganization, citing *United States* v. *Arcade Co.*, 203 F. 2d 230 (C. A. 6, 1953), certiorari denied 346 U. S. 828, and *Charles R. Mathis, Jr.*, 19 T. C. 1123 (1953).

Those cases are clearly distinguishable from the one before us here, as we shall presently indicate.

It cannot be denied that the literal requirements of section 112 (g) (1) (D) are satisfied by the bare facts of the sale here in question: petitioner sold its noninventory assets to Old Peoria, a corporation organized to purchase and receive title to those assets; a majority of petitioner's stockholders (both before and) immediately thereafter controlled Old Peoria. "Control" as defined by section 112 (h) means 80 per cent or more of the new corporation's stock. It is not necessary that 80 per cent of the shareholders of the old corporation be shareholders of the new company. *Reilly Oil Co.*, 13 T. C. 919 (1949), aff'd. 189 F. 2d 382 (C. A. 5, 1951); *Toklan Royalty Corporation* v. *Jones*, 58 F. Supp. 967 (W. D. Okla., 1944), appeal dismissed 147 F. 2d 856 (C. A. 10, 1945).

It is apparent, further, that the steps by which the transfer from petitioner to Old Peoria was made, added together, result in a clear plan of reorganization, even though no written or formal plan is evident. *William M. Liddon*, 22 T. C. ....., September 21, 1954; *Richard H. Survaunt*, 5 T. C. 665 (1945), affd. 162 F. 2d 753 (C. A. 8, 1947). To

be sure, petitioner's liquidation was the objective of its shareholders once that decision was reached in January 1948. Between that time and May 13, 1948, however, its controlling stockholders, owning 75.9 per cent of its outstanding shares, decided that should no bid exceeding $242,080 be made for the noninventory assets at the auction, they would purchase those assets for that sum and utilize them in the business of a newly organized corporation. To effect the purchase, they immediately undertook the organization of Old Peoria, all of whose stock they owned. Issuance of the charter was delayed until June 5, 1948, because the name originally selected was not available. Hence, at the auction on May 20, Silberstein bid in the property at the agreed-upon price for his "nominee or nominees", but Old Peoria paid petitioner, assumed outstanding mortgages and taxes, and took title in its name. It, thereafter, held the property, and pursuant to the powers granted it by its charter, has rented various parts thereof to some 20 or 25 tenants. It was still a going concern at the date of the hearing.

Whatever tax-saving motives may have prompted the controlling stockholders here are unimportant; what they did was to effect a reorganization of petitioner through Old Peoria. *Cf. Gregory* v. *Helvering*, 293 U. S. 465 (1935). It is unimportant, contrary to petitioner's contention, that the business carried on by the new corporation is different from that carried on by the old. *Ernest F. Becher*, 22 T. C. July 15, 1954 (on appeal C. A. 2, October 8, 1954); *Morley Cypress Trust, Schedule "B"*, 3 T. C. 84 (1944). Old Peoria, in fact, possessed the necessary powers to own and operate a distillery; it also had the authority to carry on a real estate business, which it did; and all powers possessed by it were perpetual.

United States v. *Arcade Co., supra*, and *Charles R. Mathis, Jr., supra*, cited by petitioner, are clearly distin-

guishable because in both cases, as the Court said in *Arcade Co.*, p. 233:

> * * * When the old corporation was dissolved and the assets were transferred to its former stockholders, there was a break in the continuity of ownership * * *.

Here, there was no break; and the transfer from petitioner to Old Peoria is further to be distinguished from instances where the transfer of property from one corporation to another was truly and solely incident to the liquidation of the old corporation. *Cf. Standard Realization Co.*, 10 T. C. 708 (1948), where the new corporation was organized only to assist in liquidating the old corporation's assets, and once that had been accomplished, was dissolved, in fact, prior to the old corporation.

The case here closely parallels the situation before us in *Ernest F. Becher, supra.* In both instances, the old corporation decided to liquidate because of unfavorable post-war conditions; thereafter, but prior to final dissolution, the controlling stockholders decided to acquire a part of the old corporation's assets and formed a new corporation to effect the transfer; thereafter the old corporation was dissolved, and the new corporation continued to carry on a business different from that of the old. We held there and so hold here that the result of the various steps was conclusive evidence that the transfer of property from the old corporation to the new was pursuant to a plan of reorganization within the meaning of section 112 (g) (1) (D); and, under section 112 (b) (3), no loss is recognized on the sale of petitioner's assets to Old Peoria. *Walter S. Heller*, 2 T. C. 371 (1943); affd. 147 F. 2d 376 (C. A. 9, 1945); certiorari denied 325 U. S. 868 (1945).

Decision will be entered for the respondent.

Appendix B

PEBBLE SPRINGS DISTILLING CO., PETITIONER, *vs.* COMMISSIONER OF INTERNAL REVENUE, RESPONDENT.

(U. S. Court of Appeals, Seventh Circuit, No. 11397, March 7, 1956.)

Before MAJOR, SWAIM and SCHNACKENBERG, *Circuit Judges.*

SWAIM, *Circuit Judge.* This is an appeal from a decision of the Tax Court of the United States which held that Pebble Springs Distilling Co., the petitioner herein, did not sustain a loss which the petitioner claimed resulted from the sale during 1948 of certain of its noninventory assets to another corporation, the Old Peoria Building Corporation, hereafter referred to as Old Peoria. All of the stock of the latter corporation was owned by the petitioner's principal stockholders, or members of their families, who owned sufficient stock in the petitioner to exercise control over it. Most of the facts involved in this case were stipulated by the parties.

The petitioner was organized in 1945 and on May 4, 1946, began the business of distilling whiskey and other alcoholic beverages. The corporation was authorized to issue one million shares of stock having a par value of $1.00 per share. One-half of the authorized number of shares were issued. The ownership of the issued shares, the family relationships of the owners, and their corporate positions in the petitioner are shown by the following table.

Appendix B

Shareholder	Office held in Petitioner and Relationships	Number of Shares Owned
Robert L. Silberstein	President	58,534
Helen E. Silberstein	Wife of Robert	58,633
Willard Silberstein	Brother of Robert	58,333
Julian B. Venezky	Secretary and Treasurer	62,322
Madelynn Venezky	Wife of Julian	58,433
Bernard Venezky	Brother of Julian	58,333
Lewis P. Weiner	Vice-President	25,000
Kathryn R. Weiner	Wife of Lewis	100
	Sub-total	379,688
Public Holdings— Approximately 657 separate shareholders, none of whom bore to any of the above-named shareholders any of the relationships set forth in Sec. 24(b)(2) of the Internal Revenue Code		120,312
	Total	500,000

The directors of the petitioner were Robert L. Silberstein, Lewis P. Weiner, Julian B. Venezky and E. R. Morse.

At a meeting of petitioner's stockholders on January 5, 1948, the president of petitioner, Robert L. Silberstein, reported to the stockholders the precarious condition of the whiskey market, the drastic decline in whiskey prices and the inability of the petitioner to secure sufficient additional funds to continue in the business. He then recommended, on behalf of the directors, that the company therefore be dissolved. Pursuant to the recommendation of the directors, the stockholders authorized the directors to dissolve the corporation and to liquidate its assets. The stockholders further authorized the directors to sell petitioner's plant and equipment at public auction and to distribute the proceeds of the sale and the other assets of the petitioner pro rata among the stockholders.

At that time the petitioner had a large inventory of whiskey, a part of which was distributed pro rata among the stockholders and the inventory value thereof credited to the inventory accounts on petitioner's books. At the same time the directors authorized the sale at auction of petitioner's noninventory assets, consisting of the distillery, fixtures, machinery, good will and labels, the auction

to be held at the petitioner's plant on May 20, 1948. Timely notices of this auction were sent to all of the petitioner's stockholders, and the auction was also widely publicized by display advertisements in various newspapers and by brochures mailed to all of the petitioner's stockholders and to others who might be interested.

One week before the date of the auction the petitioner's principal stockholders held a meeting which they say was for the purpose of considering what action might be taken to insure a sale of the plant at auction, and to prevent a sacrifice sale. They say that as a solution of this problem they decided to organize another corporation on behalf of which a bid of $242,080.00 would be made for the non-inventory assets of the petitioner in the event that no one else made a bid of at least that amount.

Pursuant to that agreement Old Peoria was organized. Due to an improper choice of a corporate name the certificate of incorporation was not issued until June 5, 1948. A pre-organization subscription agreement stated that the Old Peoria Building Corporation was to be "organized for the purpose of purchasing the real estate and equipment from the Pebble Springs Distilling Co." and "for such other purposes as the incorporators may determine." By that agreement all of the members of the Silberstein, Venezky and Weiner families, who together owned the majority of the stock of the petitioner, and Ellen S. Weiner, the Weiners' daughter, agreed to subscribe and pay for all of the shares of the new corporation. The stated purposes for which Old Peoria was formed included the dealing in real estate and personal property useful or convenient in the carrying on of the real estate business and of the business of a distiller, rectifier and wholesale dealer in alcoholic and nonalcoholic beverages and the manufacture, sale and distribution of whiskey and other types of alcoholic beverages.

Appendix B

Many of the petitioner's stockholders and other persons were present at the auction but the only bid that was made was by Robert L. Silberstein. He, on behalf of Old Peoria, which was still in the process of organization, bid $242,080.00 for all of the petitioner's noninventory assets. The auctioneer gave the usual opportunity for other bids but no other bid was made. The auctioneer therefore closed the auction in the usual manner and made an entry in his auctioneer's catalogue showing that the entire property offered was sold for $242,080.00 to Robert L. Silberstein, "his nominee or nominees." The published terms of this auction provided that any bid accepted by the auctioneer was subject to acceptance or rejection by the owners. On June 9, 1948, petitioner's board of directors adopted a resolution which provided that the auction sale was "in all respects ratified, confirmed and approved." The property so sold was duly conveyed and transferred to Old Peoria on June 15, 1948. After the purchase of petitioner's plant and equipment, Old Peoria rented parts of the plant for dead storage to several different tenants, but it did not, prior to the Tax Court hearing, engage in any way in the business of distilling whiskey or other alcoholic beverages. After declaring a final liquidating dividend, the petitioner was finally dissolved on November 15, 1950.

The depreciated book value of the petitioner's noninventory assets which were sold to Old Peoria was $793,508.54. On its income tax return covering the year of the sale the petitioner claimed a loss of $551,428.54. The Tax Court held that the transactions above described, culminating in the transfer of the auctioned property to Old Peoria, constituted a nontaxable reorganization under Section 112(b)(3) and (g)(1)(D) of the Internal Revenue Code of 1939, 26 U. S. C. A. Sec. 112(b)(3) and (g)(1)(D) (1945), and that therefore no loss could be claimed on the transfer.

Section 112(g) defines "reorganization" as "a transfer

by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its shaeholders or both are in control of the corporation to which the assets are transferred." Section 112(h) defines "control" as used in this section as meaning "the ownership of stock possessing at least 80 per centum of the total combined voting power of all classes of stock entitled to vote and at least 80 per centum of the total number of shares of all other classes of stock of the corporation."

There was more than sufficient evidence in this case to support the finding by the Tax Court that the transfer by the petitioner of its noninventory assets to Old Peoria constituted a reorganization within the meaning of this section. Eighty-seven and one-half per cent of the entire stock of Old Peoria was owned by members of the Silberstein, Venezky and Weiner families who also owned 75.9 per cent of the stock of the petitioner. The remaining 12½ per cent of the Old Peoria stock was owned by Ellen Weiner, the daughter of Lewis and Kathryn Weiner. The ownership of 87½ per cent of the stock of Old Peoria by the owners of 75.9 per cent of the stock of the petitioner brings this case clearly within the definition of reorganization found in Section 112(g)(1)(D) of the 1939 Internal Revenue Code.

To constitute a tax free reorganization under Section 112(g)(1)(D) of the Code it was not necessary that the persons who owned the stock of the transferee corporation should also have owned 80 per cent of the stock of the transferor corporation. In *Toklan Royalty Corp.* v. *Jones*, 58 F. Supp. 967, the court held that there was a tax free reorganization where persons owning less than 80 per cent of the stock of the original corporation owned all of the stock in the successor corporation. An appeal from this decision was dismissed per stipulation, 10 Cir., 147 F. 2d

856. This decision was followed in *Reilly Oil Co.* v. *Commissioner*, 5 Cir., 189 F. 2d 382.

Nor was it fatal to the contention of the Commissioner that the property was bid in by Robert L. Silberstein "for his nominee or nominees" before Old Peoria was organized. The sale of the auctioned property was not actually made, under the published terms of the auction, until the bid was accepted by the owner—the petitioner. The board of directors of the petitioner in a special meeting on June 9, 1948, four days after the Old Peoria charter was issued, confirmed and approved the auction sale; and on June 15, 1948, they conveyed all of the property involved to Old Peoria, just as the owners of the majority of the stock of the petitioner and the owners of all of the stock of Old Peoria had contemplated and planned. It was, of course, not required that the plan of reorganization be in any particular form or be in writing. *Ketler* v. *Commissioner*, 7 Cir., 196 F. 2d 822. Nor was it necessary that there be a transfer of all of the petitioner's assets to Old Peoria. In *Lewis* v. *Commissioner*, 1 Cir., 176 F. 2d 646, the court said, page 649: "Nor does the statute make the amount of property transferred to a new corporation a decisive factor in determining whether a reorganization took place." See also *Becher* v. *Commissioner*, 2 Cir., 221 F. 2d 252. In *Morley Cypress Trust* v. *Commissioner*, 3 T. C. 84, the original corporation distributed most of its assets in liquidation and finally transferred a remaining tract of land to a new corporation. This transfer of the remaining tract of land to the new corporation was held to be a nontaxable reorganization. To the same effect see also the decision in *Alexander* v. *Commissioner*, 2 T. C. 917. In *Lewis* v. *Commissioner*, *supra*, the court also said at page 649: "The liquidation of the old company does not change matters because a statutory reorganization may encompass as one of its incidents the liquidation of one of the corporations a party to the reorganization. [Citing cases.]"

Appendix B

In opposition to the decision of the Tax Court, the petitioner insists that the following findings of the Tax Court were without any support in the evidence (petitioner's brief, page 20):

> "(a) that petitioner's controlling stockholders 'decided that should no bid exceeding $242,080 be made for the noninventory assets at the auction, they would purchase those assets for that sum and utilize them in the business of a newly organized corporation'; (b) that Old Peoria 'was still a going concern at the date of the hearing'; and (c) that petitioner's 'controlling stockholders decided to acquire a part of the old corporation's [*i. e.*, the petitioner's] assets and formed a new corporation [*i. e.*, Old Peoria] to effect the transfer; thereafter the old corporation was dissolved, and the new corporation continued to carry on a business * * *'."

It is true that there was conflicting evidence on some of these questions. Julian B. Venezky, one of the principal stockholders and a director of the petitioner, was an attorney. He was also one of the incorporators of Old Peoria and most of the testimony for the petitioner was given by him. He testified that the principal stockholders of the petitioner prior to the auction had agreed to organize a corporation to be known as the Old Peoria Building Corporation for the purpose of buying petitioner's property which was to be sold at auction and that, pursuant to that arrangement, he had prepared a pre-organization subscription agreement. He testified that Old Peoria paid the purchase price of the auctioned property in cash and by the assumption of certain debts of the petitioner. Venezky said further that he, Silberstein and Weiner devoted their full time to the business of the petitioner.

While petitioner insists that there was no evidentiary basis for the Tax Court's finding that Old Peoria "was still a going concern at the date of the hearing" before

the Tax Court, Mr. Venezky testified as to Old Peoria that: "We have rented these buildings out for storage, 20 to 25 concerns * * * and they pay rent * * *." Venezky thus furnished evidence that Old Peoria was still "a going concern" at the time of the hearing, as the Tax Court found. The property sold at the auction consisted of a completely equipped distillery situated on a plot of 2.2 acres of ground, with buildings having floor space of more than 46,000 square feet. The plant contained adequate equipment for a daily production of 14,400 proof gallons of whiskey. As we have pointed out above, the property purchased by Old Peoria was sufficient for it to have immediately started distilling whiskey.

The stockholders of Old Peoria now say that they never intended to distill whiskey in this plant. But in the pre-organization subscription agreement they said that the purpose of organizing Old Peoria was to purchase the real estate and equipment of the petitioner and "for such other purposes as the incorporators may determine." In the articles of incorporation, the incorporators, including Mr. Venezky, stated that one of the purposes of the corporation was "to manufacture, buy, sell and deal in * * * whiskey of all kinds * * * and to do and perform all kinds of distilling * * *." In the articles of incorporation they also estimated that during the first year after its incorporation Old Peoria would do $50,000.00 of business. Certainly the incorporators would not have estimated this amount of business if they had then intended that their only business would consist of renting dead storage space. Silberstein, Weiner and Venezky all signed the articles of incorporation of Old Peoria and swore that the statements contained therein were true. Under these circumstances the Tax Court, of course, had a right to accept the sworn statements of the incorporators of Old Peoria as to their purposes in incorporating and in buying the assets of the

petitioner, rather than their later contention that their sole purpose was "to protect petitioner's 657 public shareholders."

Section 112(a)(3) of the Code recognizes a transfer as tax free only when there is an exchange solely of stock or securities of "a corporation a party to a reorganization," in pursuance of the plan of reorganization, for stock or securities in such corporation or in another corporation a party to the reorganization. Section 112(b)(4) provides that no gain or loss shall be recognized if a corporation a party to the reorganization exchanges properties, pursuant to a plan of reorganization, solely for stock or securities in another corporation a party to the reorganization. But Section 112(c) provides that if property other than stock or securities be involved in such a transaction any gain shall be limited to that the other party received. Section 112(e) provides that on such an exchange no loss shall be recognized.

An analysis of all of the evidence in this case and of the relevant sections of the Code convinces us that there was a proper basis for the conclusion of the Tax Court that on the transfer here in question the claimed loss by the petitioner could not be sustained.

The judgment of the Tax Court is

AFFIRMED.

APPENDIX C

UNITED STATES v. ARCADE CO., ET AL.
No. 11584.

UNITED STATES COURT OF APPEALS.
Sixth Circuit.
April 7, 1953.

Before SIMONS, *Chief Judge*, and MARTIN and MCALLISTER, *Circuit Judges*.

MCALLISTER, *Circuit Judge*.

The issue in this case is whether certain business transactions amounted to a corporate reorganization under Section 112(g) of the Internal Revenue Code, Title 26 U. S. C. A. § 112(g). The district court held that there was no reorganization, and the government appealed.

The facts are as follows: The Arcade Company, organized in 1902, long prior to the enactment of the Federal Income Tax Amendment, employed, in 1943, a tax accountant and attorneys to work out a plan to minimize federal taxes and provide for a larger share of the company's earnings for its stockholders. As a result, on September 22, 1943, the stockholders of the company, by resolution, voted to surrender its charter and dissolve the corporation on September 30, 1943; and the corporation was, accordingly, dissolved. The resolution further provided for two trustees in whom the assets of the dissolved corporation should be vested for disposition to the stockholders, or in such manner as they should direct. The former stockholders gave directions in writing to the trustees that the assets be transferred to a new corporation, to be there-

after organized, in return for its newly issued stock. Subsequently, the assets were transferred to a new corporation, Arcade Company, Inc., by the trustees, and in payment for the assets, the new company, delivered to the trustees for the stockholders shares of its stock for the assets of the old company. Thereafter, the trustees transferred the shares of stock to the beneficiaries of the trusts for which they were acting—the persons who had been stockholders in the old company—in the same proportion as in the old company.

The tax incident that gives rise to this controversy relates to the claim of a deduction for ordinary business expense. The Arcade Company claimed that the expense of the tax accountant and attorneys whom it employed to work out the plan to provide a larger share of the company's earnings for its stockholders was an ordinary and necessary expense in carrying out its business. The Commissioner determined that such expense was a capital expenditure rather than a current expense, and that it was not deductible. The district court, however, determined that it was deductible as a necessary business expense.

In contending that the transaction in question constituted a reorganization, the government relies upon the definition of a reorganization as set forth in Title 26 U. S. C. A. § 112(g)(1). Appellee contends that there was no continuity between the old corporation and the new corporation, and that, under the relevant provisions of the statute, there was no reorganization; that the costs and expenses of counsel and auditors in preparing the plan were necessary business expenses of the old corporation, and, therefore, properly deductible; and that the judgment of the district court should be affirmed.

Title 26 U. S. C. A. § 112(g)(1), defines a reorganization, as follows:

"(D) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its shareholders or both are in control of the corporation to which the assets are transferred."

Title 26 U. S. C. A. § 112(g)(2), provides:

"The term 'a party to a reorganization' includes a corporation resulting from a reorganization and includes both corporations in the case of a reorganization resulting from the acquisition by one corporation of stock or properties of another."

Title 26 U. S. C. A. § 112(b)(4), provides:

"No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization."

[1] An exchange of property for stock in which gain or loss is not recognized under the Internal Revenue Act must satisfy the following requirements: (1) there must be a reorganization, as that term is defined in the statute; (2) the corporation must transfer "property;" (3) such property must be exchanged for stock or stock and securities, except that an assumption of liabilities or the taking subject to liabilities for the transferee corporation may also be a part of the consideration; (4) the exchange must be made in pursuance of the plan of reorganization; (5) both the transferor and the corporation, the stock or securities of which are received, must be a party to the reorganization. Mertens' Law of Federal Income Taxation, Volume 3, Section 20.65 (page 236).

[2] The government claims that the transactions above set forth constituted a reorganization, as defined in Title 26 U. S. C. A. § 112(g), and that the taxpayer corporation was liable for the deficiency assessment theretofore made,

with interest. This contention is based upon the claim that the dissolution of the old corporation, the transfer of its assets to trustees for the stockholders, the organization of a new corporation, the direction by the former stockholders to the trustees to exchange the assets of the old corporation to the new corporation in consideration of the delivery of stock in the new corporation, was an integrated plan of reorganization, not to discontinue the business of the old corporation, but, rather, to continue the same business more profitably under a new guise. It is to be observed, however, that the legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, by means which the law permits, can not be doubted. *Gregory* v. *Helvering*, 293 U. S. 465, 55 S. Ct. 266, 79 L. Ed. 596.

[3-8] In the light of the above mentioned sections of the Internal Revenue Code, we compare what was actually done in this case, with these various statutory provisions.

In the first place, the charter of the old company was surrendered and the corporation was dissolved before the new corporation received the assets through transfer by the trustees. Manifestly, there could be no transfer by the old corporation of its assets to the new corporation which, in the strict language of the statute, is required in order to constitute a reorganization. Nor was there an exchange of property by the old corporation to the new corporation for the latter's stock, nor were there any agreements between the old and new corporations, or exchanges between them, pursuant to a plan of reorganization, all of which are necessary to reorganizations under section 112(g)(1). When the old corporation was dissolved, it was at an end and liquidated. Its assets were transferred to its former stockholders, or what was the same thing, to trustees for their benefit. The former stockholders paid income tax in the way of a capital gains tax on what they had received

from their stock as a liquidating dividend. There was no right on the part of the dissolved corporation to enforce any agreement as to what was to take place subsequent to its dissolution. It had no rights or obligations, as far as any plan to form a new corporation was concerned, or to see that the trustees for the former stockholders entered into such a plan or transferred the assets to a new corporation. The former stockholders at the time of the liquidation of the old corporation were the absolute owners of the corporate assets. They were under no contractual obligations to form a new corporation or to transfer their assets to a new corporation in return for stock therein. They could have sold the assets to an outside real estate corporation or an individual, and in such a case, there could have been no claim that any reorganization had resulted from the transactions. The former stockholders of the old corporation had not bound themselves to carry out any plan of reorganization. The new corporation had no rights that could be enforced against the former stockholders of the old corporation to require them to form a new corporation, or, for that matter, any rights whatever with respect to the old corporation or the former stockholders thereof. Apparently the government contends that because the old corporation employed a tax accountant and lawyers to work out a plan whereby stockholders could secure a larger share of the company's earnings, and that, subsequently, the corporation followed the advice given, and the stockholders later acted upon it, there was a "plan of reorganization" within the intendment of the statute, and that the transactions above mentioned amounted to a reorganization pursuant to a plan therefor. But the "plan of reorganization," specified by the statute, is not just any suggestion or advice received from a lawyer or a tax accountant, even though it be acted upon by either a corporation, or its stockholders, or

both. What is envisaged by a "plan of reorganization" within the intendment of the statute may be perceived in one of the provisions of the Treasury Regulations promulgated to carry out Section 112 of the Internal Revenue Code, under the heading of "Records to be Kept and Information to be Filed With Returns." "The plan of reorganization must be adopted by each of the corporations parties thereto; and the adoption must be shown by the acts of its duly constituted responsible officers, and appear upon the official records of the corporation." Treasury Reg. 103, Section 19.112(g)-6, Title 26 Code of Federal Regulations, 29.112(g)-6. When the old corporation was dissolved and the assets were transferred to its former stockholders, there was a break in the continuity of ownership, for, as a general rule, a corporation and its stockholders are deemed separate entities; and this is true in respect to tax problems. *New Colonial Ice Co., Inc.* v. *Helvering*, 292 U. S. 435, 54 S. Ct. 788, 78 L. Ed. 1348. The dissolution of the old company and the transfer of its assets to its former stockholders put a period to its existence. The new company was a different and separate enterprise. It is notable that throughout the regulations governing reorganizations under Title 26 U. S. C. A. § 112(g), it is set forth variously that the terms, "reorganization" and "party to a reorganization", mean only a reorganization or a party to a reorganization as defined in section 112(g); that, in order to exclude transactions not intended to be included, the *specifications* of the reorganization provisions of the law are *precise*, and that both the terms of the specifications and their underlying assumptions and purposes must be satisfied in order to entitle the taxpayer to the benefit of the exception to the general rule; that the application of the term, "reorganization," is to be *strictly* limited to the *specific* transaction set forth in section 112(g)(1); that the term, "a party to a reorganiza-

tion", includes, in addition to a corporation which performs the *specific* act constituting the reorganization, as described and defined in section 112(g)(1), only a corporation specified in section 112(g)(2); that the term, "plan of reorganization," has reference to a consummated transaction *specifically* defined as a reorganization under section 112(g)(1), and that the term is not to be construed as broadening the definition of reorganization as set forth in that section; and, as heretofore mentioned, that the plan of reorganization must be adopted by each of the corporations parties thereto. Title 26, Code of Federal Regulations, 29.112(g)-1 to (g)-6, inclusive. We do not find, in what is here claimed by the government to constitute a "plan of reorganization," and a "reorganization," any such transactions, so precisely specified, so strictly limited to the language of the statute, and providing for such express adoption by the corporations, as are required by the regulations governing reorganizations under the taxing statute. We are of the opinion that the transactions in question did not constitute a reorganization under the Internal Revenue Code.

In *Braicks* v. *Henricksen*, D. C. Wash., 43 F. Supp. 254, where the taxpayer was concerned with seeking allowance of a dividends paid credit on an undistributed profits tax, the court was confronted with a problem almost identical to the one before us. It appeared in that case that in 1937, the directors of a corporation, called the Old Company, "concluded that the stated value of its capital stock was too low and that the corporation was paying excess profits taxes in an amount larger than the company's situation required. For the sole purpose of attempting to correct the situation and on the advice of the corporation's tax counsel, the following plan was devised and effectuated: (1) Proceedings were instituted for the liquidation of the Old Company. (2) All of the assets of the Old Company

were transferred to plaintiffs as trustees for the stockholders and as liquidating trustees of the company by the declaration of a liquidating dividend. (3) The stockholders of the Old Company were advised by the company that the receipt on their behalf by the trustees of their proportionate share in the assets of the Old Company constituted a dividend subject to tax and every stockholder was advised as to the increase in his income tax resulting from the receipt of such dividend. (4) With one exception, each of the stockholders paid such income tax in accordance with such advice. (The exception was an isolated one and his failure to pay had no connection with the corporation or the plan.) (5) Contemporaneous with these transactions, [the New Company] was formed. (6) Each stockholder of the Old Company was notified that he was free to choose as to whether or not to enter into the New Company and financial arrangements were made to make possible the purchase for cash from each stockholder of his proportionate share of the assets held for him by the plaintiffs as trustees. (7) Each stockholder subscribed for the stock of the New Company, the stock subscription obligation being payable in cash. (8) The subscribers to the capital stock of the New Company thereupon offered to the New Company that they would cause to be transferred to the New Company all of the assets held for them by the trustees subject to the obligations of the Old Company which the New Company was to agree to pay in fulfillment of their capital stock subscriptions of the New Company. (9) The New Company accepted the offer and stock was issued to the individuals in the same proportionate share as they owned stock in the Old Company. (10) The assets were shown on the books of the New Company as of their net value as shown on the books of the old Company. (11) The dissolution of the Old Company was completed." On the foregoing facts, the district court held that the trans-

action was not a "reorganization" but was a "liquidation," and that the liquidating trustees, in making income tax returns for the year in which the transaction occurred, were entitled to a dividend paid credit on such portion of the amount distributed in liquidation which was properly chargeable to earnings or profits of the Old Company accumulated after February 28, 1913. On review, 9 Cir., 137 F. 2d 632, the judgment of the district court was affirmed, the court of appeals saying that the pivotal point in the case was whether or not there was a real and bona fide distribution in liquidation made to the stockholders in the old company, and if there was such an actual distribution—however brief the interval during which each individual stockholder retained title to his share of the assets—then the taxpaying corporation was entitled to a dividends paid credit on the ground that the transaction was a liquidation rather than a reorganization. The court held that the evidence disclosed that there was an actual distribution to each stockholder, who thereafter could exercise an independent choice as to whether he would or would not go into the new company.

In its attempts to distinguish the *Braicks* case, *supra*, the government submits that the court therein did not find that the old company had adopted a plan of reorganization, but that it did find that the stockholders were advised that they were free to retain and dispose of their interest in the assets of the old company and to choose whether or not they would enter into the new company; and it is implied that this advice that the stockholders were free to act in the matter differentiated that controversy from the one before us. But in the instant case, there was no plan of reorganization adopted by the old company; and each stockholder, prior to the dissolution of the old corporation, received notice of the special meeting to consider acting upon arrangements to distribute the property of the

company pro rata among the shareholders or to convey the property to a trustee for their benefit. After the meeting, the former stockholders were notified in writing that provision had been made for the transfer of the assets to the trustees, and a suggested letter was submitted that stockholders could direct to the trustees. This proposed letter set forth how much stock had been owned by the stockholder, and directed the trustees to ascertain when and if a new corporation had been organized to do business similar to that of the old company. The proposed letter further authorized the trustees to transfer all of the assets of the old corporation to such a new corporation under certain conditions. It can hardly be concluded that the stockholders did not have the right, after the assets of the old company had been transferred to them or their trustees, to exercise, each for himself, an independent choice as to whether or not he would, or would not go into the new corporation. No one else could exercise the right for him or require him to do so. We are of the opinion that the distinction which the government seeks to draw between the two cases is without substance, and we are persuaded by the reasoning of the court in the *Braicks* case.

Many authorities are cited by appellant in support of its contentions, and, in relying upon them, the government emphasizes that where transactions result in a new corporation which emerges and actually uses the transferred assets to continue the business with the same proprietary interests, such transactions amount to a reorganization. But the cases cited, are not here in point, and circumstances disclosed, as above mentioned, are not in themselves controlling. See *Glenn* v. *Courier-Journal Job Printing Co.*, 6 Cir., 127 F. 2d 820. Here, there was a liquidation of the old company, and, as said by Judge Simons in *Mascot*

Stove Co. v. *Commissioner*, 6 Cir., 120 F. 2d 153, "liquidation is the antithesis of reorganization."

[9] It is our conclusion that there was no transfer by the old corporation of its assets to the new corporation, within the meaning of section 112(g)(1); that neither the old nor the new corporation was a "party to a reorganization", as set forth in section 112(g)(2); and that the transactions out of which this controversy arose did not constitute a reorganization within the intendment of the Internal Revenue Code.

Having held against appellant upon the question of reorganization, and having concluded that the transactions in question amounted to liquidation of the old corporation, we are of the opinion that the services of the tax accountant and attorneys, here in question were rendered to the old corporation; that the expenses incurred therefor were for the benefit of the old corporation; and, since they constituted ordinary and necessary expense in carrying on its business, they were properly deductible. To the same effect, see *Braicks* v. *Henricksen*, D. C., 43 F. Supp. 254, 261.

In accordance with the foregoing, the judgment of the district court is affirmed.

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statute involved	2
Statement	2
Argument	4
Conclusion	9
Appendix	10

CITATIONS

Cases:

Becher v. *Commissioner*, 22 T. C. 932, affirmed, 221 F. 2d 252 — 6

Cortland Specialty Co. v. *Commissioner*, 60 F. 2d 937, certiorari denied, 288 U. S. 599 — 7

Heller v. *Commissioner*, 2 T. C. 371, affirmed, 147 F. 2d 376, certiorari denied, 325 U. S. 868 — 6

Helvering v. *Limestone Co.*, 315 U. S. 179 — 7

Helvering v. *Minnesota Tea Co.*, 296 U. S. 378 — 7

Ketler v. *Commissioner*, 196 F. 2d 822 — 6

Lewis v. *Commissioner*, 176 F. 2d 646 — 6

Liddon v. *Commissioner*, 230 F. 2d 304 — 6, 7

Mathis v. *Commissioner*, 19 T. C. 1123 — 6

Pinellas Ice Co. v. *Commissioner*, 287 U. S. 462 — 7

Reilly Oil Co. v. *Commissioner*, 189 F. 2d 382 — 5

Scofield v. *San Antonio Transit Co.*, 219 F. 2d 149, certiorari denied, 350 U. S. 823 — 7

Toklan Royalty Corp. v. *Jones*, 58 F. Supp. 967, dismissed, 147 F. 2d 856 — 5

United States v. *Arcade Co.*, 203 F. 2d 230, certiorari denied, 346 U. S. 828 — 7

Statute:

Internal Revenue Code of 1939:

Sec. 24 (b) (26 U. S. C. 1952 ed., Sec. 24 (b)) — 8, 10

Sec. 112 (a) (26 U. S. C. 1952 ed., Sec. 112 (a)) — 11

Sec. 112 (b) (26 U. S. C. 1952 ed., Sec. 112 (b)) — 7, 11

Statute—Continued

Internal Revenue Code of 1939—Continued — Page

Sec. 112 (c) (26 U. S. C. 1952 ed., Sec. 112 (c)) — 7
Sec. 112 (e) (26 U. S. C. 1952 ed., Sec. 112 (e)) — 7, 12
Sec. 112 (g) (26 U. S. C. 1952 ed., Sec. 112 (g)) — 5, 12
Sec. 112 (h) (26 U. S. C. 1952 ed., Sec. 112 (h)) — 5, 13
Sec. 3797 (a) (26 U. S. C. 1952 ed., Sec. 3797 (a)) — 13

Miscellaneous:

Lyons, *Realignment of Stockholders' Interests in Reorganizations*, 9 Tax L. Rev. 237, 239 (1954) — 8

Treasury Regulations 111:

Sec. 29.112 (g)-1 — 8
Sec. 29.112 (g)-2 — 8

In the Supreme Court of the United States

OCTOBER TERM, 1956

No. 223

PEBBLE SPRINGS DISTILLING CO., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (Pet. 23–32) are reported at 23 T. C. 196. The opinion of the Court of Appeals (Pet. 33–41) is reported at 231 F. 2d 288.

JURISDICTION

The judgment of the Court of Appeals was entered on March 7, 1956. A petition for rehearing was denied on April 4, 1956. The petition for a writ of certiorari was filed on July 2, 1956. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254 (1).

QUESTION PRESENTED

Whether the taxpayer's noninventory assets were transferred to the new corporation in a tax-free exchange so that no loss was recognizable under Section 112 of the 1939 Internal Revenue Code.

STATUTE INVOLVED

The pertinent provisions of Sections 24, 112 and 3797 of the Internal Revenue Code of 1939 are set forth in the Appendix, *infra*, pp. 10–13.

STATEMENT

The facts, as found by the Tax Court (Pet. 24–28), and as stated by the Court of Appeals (Pet. 33–36), may be summarized as follows:

The taxpayer-corporation was organized in 1945 and began the business of distilling whiskey in 1946. Taxpayer had 500,000 outstanding shares of stock. The ownership of these shares, the family relationships of the owners, and the offices held by them in taxpayer are shown by a table that is incorporated in the findings. (Pet. 24, 33–34.)

At a meeting of stockholders on January 5, 1948, the president of taxpayer reported the precarious condition of the whiskey market, the drastic decline in whiskey prices, and the inability of the taxpayer to secure sufficient additional funds to continue in the business. He then recommended, on behalf of the directors, that taxpayer be dissolved. Pursuant to that recommendation, the stockholders authorized liquidation and further authorized the directors to sell taxpayer's plant and equipment at public auction and

to distribute the proceeds of the sale and the other assets of taxpayer to its stockholders. (Pet 25, 34.)

Taxpayer had a large inventory of whiskey, a part of which was distributed pro rata among the stockholders in April, 1948. The directors also authorized sale of taxpayer's noninventory assets (consisting of the distillery, fixtures, machinery, good will and labels) at an auction to be held on May 20, 1948. Timely notice was given to stockholders and others. (Pet. 25–26, 34–35.)

One week before the date of the auction, taxpayer's principal stockholders held a meeting for the purpose of considering what action might be taken to insure a sale of the plant at auction, and to prevent a sacrifice sale. As a solution of this problem they decided to organize another corporation on behalf of which a bid of $242,080 would be made for the noninventory assets of the taxpayer in the event that no one else made a bid of that amount or more. (Pet. 26, 35.)

Pursuant to that agreement, Old Peoria was organized. Due to an improper choice of name the certificate of incorporation was not issued until June 5, 1948. This charter authorized the new corporation, *inter alia*, to carry on the real estate business and the liquor distilling business. Eighty-seven and one-half percent of the entire stock of Old Peoria was owned by members of the Silberstein, Venezky and Weiner families who also owned 75.9 percent of the stock of taxpayer, as shown by the table referred to above. The remaining 12½ percent of the Old Peoria stock was owned by Ellen S. Weiner, the Weiners' daughter (Pet. 26, 35, 37.)

At the auction on May 20, 1948, Silberstein bid $242,080 for taxpayer's noninventory assets. No other bids were made. The auctioneer's memorandum of the sale showed that all of the property was sold for $242,080 to Silberstein, "his nominee or nominees." (Pet. 27, 36.) On June 9, 1948, taxpayer's directors approved the auction sale, and on June 15, 1948, the assets so sold were conveyed to Old Peoria. Thereafter Old Peoria rented parts of the plant for dead storage to several different tenants, but it did not, prior to the Tax Court hearing, engage in any way in the business of distilling whiskey. (Pet. 27, 36.) After declaring a final liquidating dividend, taxpayer was finally dissolved on November 15, 1950. (Pet. 28, 36.)

The depreciated book value of the taxpayer's noninventory assets which were sold to Old Peoria was $793,508.54. On its income tax return for the fiscal year ended March 31, 1949, taxpayer claimed a loss of $551,428.54 from the auction sale and undertook to carry it back to the two preceding taxable years as a net operating loss. (Pet. 28, 36.)

The Commissioner determined that no such net operating loss deduction was allowable. The Tax Court sustained the Commissioner's determination (Pet. 28), and the Court of Appeals affirmed. (Pet. 41.)

ARGUMENT

The decision below, affirming that of the Tax Court, is clearly correct. There is no conflict of decisions, and there are no other grounds calling for further review.

1. Both of the courts below held, correctly we submit, that the transfer by taxpayer of its noninventory assets to Old Peoria constituted a reorganization so that no loss is recognizable under Section 112 of the Internal Revenue Code of 1939 (Appendix, *infra*, pp. 11–13).

This case falls squarely within Sections 112 (g) (1), which defines the term "reorganization" to include (clause D) "a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its shareholders or both are in control of the corporation to which the assets are transferred." And under Section 112 (h) the ownership of 80 per cent of the transferee's stock constitutes control. While it is necessary that 80 per cent of the stock of the transferee be held by stockholders of the transferor, it is not necessary that such stockholders shall have held as much as 80 per cent of the stock of the transferor. *Reilly Oil Co.* v. *Commissioner*, 189 F. 2d 382 (C. A. 5th); *Toklan Royalty Corp.* v. *Jones*, 58 F. Supp. 967 (W. D. Okla.), appeal dismissed by stipulation, 147 F. 2d 856 (C. A. 10th).

In the instant case it is undisputed that more than 80 percent of the stock of Old Peoria was owned by persons who held 75.9 percent of the taxpayer's stock. The literal requirements of Section 112 (g) (1) (D) are therefore satisfied, and both of the courts below so held. (Pet. 30, 37.)

Moreover, the transfer to Old Peoria was made precisely as the owners of the majority of the stock of taxpayer and all of the stock of Old Peoria had

contemplated and planned. In the circumstances, there was a sufficient plan of reorganization. *Ketler* v. *Commissioner,* 196 F. 2d 822 (C. A. 7th); *Heller* v. *Commissioner,* 2 T. C. 371, affirmed, 147 F. 2d 376 (C. A. 9th), certiorari denied, 325 U. S. 868; *Mathis* v. *Commissioner,* 19 T. C. 1123, 1128. The rulings below are also supported by cases such as *Becher* v. *Commissioner,* 22 T. C. 932, affirmed, 221 F. 2d 252 (C. A. 2d); *Lewis* v. *Commissioner,* 176 F. 2d 646 (C. A. 1st); *Liddon* v. *Commissioner,* 230 F. 2d 304 (C. A. 6th), petition for certiorari filed May 18, 1956 (No. 93, October Term, 1956). In all those cases, on similar facts, it was concluded that there was a reorganization.

Since there was a reorganization in the instant case, it necessarily follows that no loss is recognizable. The essence of the transactions was that taxpayer's majority stockholders received the stock of Old Peoria plus property in the form of taxpayer's liquidating distributions, in exchange for their stock in taxpayer, which was canceled either in form or in effect upon taxpayer's liquidation and dissolution. Thus, as to taxpayer's majority stockholders, there was an exchange of stock for stock plus other property; and as to the old corporation, there was an exchange of part of its assets for stock of the new corporation (which, while not directly received by the old corporation, went to its stockholders as its nominees, in effect) plus other property in the form of the cash and other valuable considerations received directly from Old Peoria by the old corporation. There was thus, as the courts below held (Pet. 32, 41), a non-

taxable exchange under Section 112 (b) (3) and (4), with recognition of gain being limited to other property received in the exchange (Section 112 (c)), and recognition of loss being denied altogether under Section 112 (e). And the courts below in effect so held.

Citing *Cortland Specialty Co.* v. *Commissioner,* 60 F. 2d 937 (C. A. 2d), certiorari denied, 288 U. S. 599; *Pinellas Ice Co.* v. *Commissioner,* 287 U. S. 462, taxpayer asserts (Pet. 7–8) that there was here a mere sale for cash and not a reorganization. Those cases, however, did not involve sales to controlled corporations; they did not deal with the statute here involved; and they are not inconsistent with the instant decision where the majority stockholders of taxpayer owned over 80 percent of the stock of Old Peoria so that the requisite continuity of interest was preserved and there was a reorganization under Clause (D). And see *Helvering* v. *Minnesota Tea Co.,* 296 U. S. 378, 384–385; *Helvering* v. *Limestone Co.,* 315 U. S. 179–182.

Taxpayer contends (Pet. 8–9) that the instant decision conflicts with *United States* v. *Arcade Co.,* 203 F. 2d 230 (C. A. 6th), certiorari denied, 346 U. S. 828; *Scofield* v. *San Antonio Transit Co.,* 219 F. 2d 149 (C. A. 5th), certiorari denied, 350 U. S. 823. However, the *Arcade* case is distinguishable on the facts as the Tax Court in the instant case pointed out (Pet. 31–32). It was also distinguished by the Sixth Circuit itself in the *Liddon* case, *supra,* 230 F. 2d at pp. 307–308, where the situation was comparable to the one here. The *San Antonio* case did not involve the reorganization provision involved here (Section 112

(g) (1) (D) of the 1939 Code), and the facts there are plainly far different from those in the case at bar.

The taxpayer also refers (Pet. 13–15) to Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939, Sections 29.112 (g)–1 and 29.112 (g)–2, which provide that "a sale is nevertheless to be treated as a sale, even though the mechanics of a reorganization have been set up" and that the "term [reorganization] does not embrace the mere purchase by one corporation of the properties of another corporation, for it imports a continuity of interest on the part of the transferor or its stockholders in the properties transferred." But these Regulations are in no way inconsistent with the conclusion of the courts below that there was a reorganization in the instant case. The transaction, although employing the form of a sale in respect of one step in a series of steps, nevertheless amounted in substance to a reorganization under the specific provisions of Clause D, and the requisite continuity of interest was present. See Lyons, *Realignment of Stockholders' Interests in Reorganizations*, 9 Tax L. Rev. 237, 239 (1954).[1]

[1] In the Court of Appeals, the Commissioner contended in the alternative that if Section 112 is inapplicable, and if taxpayer's contention be accepted that Old Peoria had no business purpose other than facilitation of taxpayer's liquidation, then there was a sale to a related taxpayer and the claimed loss deduction with respect to that sale was properly disallowed under Section 24 (b) of the 1939 Code (Appendix, *infra*, p. 10). The court below, in view of its disposition of the case, did not find it necessary to reach that question.

CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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AUGUST 1956.

APPENDIX

Internal Revenue Code of 1939:

SEC. 24. ITEMS NOT DEDUCTIBLE

* * * * *

(b) *Losses from Sales or Exchanges of Property.*—

(1) *Losses Disallowed.*—In computing net income no deduction shall in any case be allowed in respect of losses from sales or exchanges of property, directly or indirectly—

* * * * *

(B) Except in the case of distributions in liquidation, between an individual and a corporation more than 50 per centum in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual;

* * * * *

(2) *Stock Ownership, Family, and Partnership Rule.*—For the purposes of determining, in applying paragraph (1), the ownership of stock—

* * * * *

(B) An individual shall be considered as owning the stock owned, directly or indirectly, by or for his family;

(C) An individual owning (otherwise than by the application of subparagraph (B)) any stock in a corporation shall be considered as owning the stock owned, directly or indirectly, by or for his partner;

(D) The family of an individual shall include only his brothers and sisters (whether by the whole or half blood),

spouse, ancestors, and lineal descendants; and

(E) Constructive Ownership as Actual Ownership.—Stock constructively owned by a person by reason of the application of subparagraph (A) shall, for the purpose of applying subparagraph (A), (B), or (C), be treated as actually owned by such person, but stock constructively owned by an individual by reason of the application of subparagraph (B) or (C) shall not be treated as owned by him for the purpose of again applying either of such subparagraphs in order to make another the constructive owner of such stock.

* * * * *

(26 U. S. C. 1952 ed., Sec. 24.)

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges Solely in Kind.*—

* * * * *

(3) *Stock for Stock on Reorganization.*—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation, a party to the reorganization.

(4) *Same—Gain of Corporation.*—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

* * * * *

(e) [as amended by Sec. 121 (d) (3) of the Revenue Act of 1943, c. 63, 58 Stat. 21] *Loss From Exchanges Not Solely in Kind.*—If an exchange would be within the provisions of subsection (b) (1) to (5), inclusive, or (10), or within the provisions of subsection (1), of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain or loss, but also of other property or money, then no loss from the exchange shall be recognized.

* * * * *

(g) [as amended by Sec. 213 (b) of the Revenue Act of 1939, c. 247, 53 Stat. 862, and Section 121 (d) (4) of the Revenue Act of 1943, *supra*] *Definition of Reorganization.*—As used in this section (other than subsection (b) (10) and subsection (1)) and in section 113 (other than subsection (a) (22))—

(1) The term "reorganization" means (A) a statutory merger or consolidation, or (B) the acqusition by one corporation, in exchange solely for all or a part of its voting stock, of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation, or (C) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of substantially all the properties of another corporation, but in determining whether the exchange is solely for voting stock the assumption by the acquiring corporation of a liability of the other, or the fact that property acquired is subject to a liability, shall be disregarded, or (D) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its shareholders or both are in control of the corporation to which the assets are transferred, or (E) a recapitaliza-

tion, or (F) a mere change in identity, form, or place of organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of a reorganization resulting from the acquisition by one corporation of stock or properties of another.

(h) *Definition of Control.*—As used in this section the term "control" means the ownership of stock possessing at least 80 per centum of the total combined voting power of all classes of stock entitled to vote and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

* * * * *

(26 U. S. C. 1952 ed., Sec. 112.)

SEC. 3797. DEFINITIONS.

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

* * * * *

(2) *Partnership and Partner.*—The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization.

* * * * *

(26 U. S. C. 1952 ed., Sec. 3797.)

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